



Republican Policy Committee

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Congress vs. Clinton: Re-targeting vs. De-targeting the EITC

Despite the President's best attempts at obfuscation, the Earned Income Tax Credit (EITC) is a troubled program racked by fraud, abuse, and exploding costs. Yet, nowhere is the White House's use of double-speak to fight against reform more evident than in discussions about this misunderstood provision of the tax code.

The Senate Finance Committee's proposal is simple: stop the drift in the program that has targeted the EITC away from its focus on low-income families, away from encouraging work, and away from even eligible recipients. In short, the Senate's proposal returns the program to its original goals. The result is an *increase in spending on intended beneficiaries* and a decrease in money being spent on fraud and abuse and in providing perverse disincentives; in so doing, it saves taxpayers \$32.5 billion.

Re-Targeting the EITC

The Senate's proposal will:

- **Return EITC's focus** to working low-income families with children;
- **Increase** the program's intended work incentives;
- **Increase** overall EITC spending in every one of the next seven years above the \$19.8 billion spent in 1995;
- **Increase** EITC spending to \$22.8 billion in 2002 and spend \$152.9 billion over seven years on this program;
- **Increase** the maximum credit for families with one child in every year — from \$2,094 in 1995 to \$2,615 in 2002;
- **Increase** the maximum credit for families with two children in every year — from \$3,110 in 1995 to \$3,888 in 2002;
- **Raise** the income ceiling for obtaining the maximum credit (thus keeping the maximum credit obtainable) in every year — from \$11,290 in 1995 to \$14,100 in 2002; and
- **Decrease** the program's rampant fraud and abuse.

That Was Then, This Is Now

"You know, President Reagan said it [EITC] was the best anti-poverty program ever devised."
(President Clinton, *The New York Times*, 9/19/95)

By Clinton's logic, if you liked steak you would love a cattle stampede. The problem is not in what the EITC was intended to be but in what it has become and why. Yet, looking at the current debate over the EITC, it would seem that President Clinton's fondness for the programs of Republican presidents seems to increase as they move farther from their original purpose.

Begun in 1975 as a temporary program under President Ford to encourage work over welfare for low-income families with children, the EITC was made permanent under President Carter in 1978. While EITC is called a tax credit, it is for most recipients a cash grant — something akin to a reverse income tax. In fact, 84 percent of the program's costs are cash grants. Recipients get an offset of any income tax liability they might have, and then any excess they are entitled to is sent to them from the IRS just as a tax refund would be sent to those paying excess income tax. Earned income is the determining factor. In the "phase-in range," up to 30 cents is added to every dollar earned; however, after passing over a "hump," recipients enter the EITC's "phase-out range" where as income rises, the level of benefits fall.

When President Reagan won the White House in 1980, the EITC program had a \$2 billion annual cost and a \$500 maximum credit. Since then EITC has exploded, growing 1,100 percent in just the last 10 years; and if not reformed, it will continue to grow to \$31 billion in 2000. This growth explosion is due to the fact that the EITC has been increasingly aimed at areas other than its intended target.

De-Targeting the EITC

The EITC's intended target is low-income working families with children. Yet, now, vast sums of money benefit others.

- It's no longer just low-income people who qualify:
 - As Senate Finance Chairman William Roth writes in the preface to an August 1995 Joint Economic Committee study: "[A] part-time lawyer who works 100 hours per year at \$100 per hour can get the same benefits as a fry-cook who works 2,000 hours per year at \$5 per hour." Further, a wealthy divorcee who receives hundreds of thousands of dollars in child support yet earns less than \$10,000 in income can qualify, while a family of four with an income of only \$30,000 will pay the taxes which ultimately benefit the well-off mother.
 - Under the 1993 law signed by President Clinton that greatly expanded the scope of EITC, families making up to \$34,613 will qualify by 2002.
 - "The EITC is not only the fastest-growing entitlement program, it's the broadest. In 1986 some 7 million families were covered by the EITC, and the average outlay by the government was \$281. This year 18 million families are covered at an average of \$1,265."
(James Glassman, *Washington Post*, 10/12/95)

- EITC no longer encourages work:

- Most recipients of EITC are at income levels beyond that which earns them the maximum tax credit, the so-called "phase-out" realm. Thus, these people lose tax-credit money for every additional dollar they earn, and so they are facing marginal tax rates that are higher than those faced by the richest Americans. James K. Glassman quotes economist Bruce Bartlett from a National Center for Policy Analysis report, who notes, "Families with incomes between \$11,000 and \$26,000 are being taxed at the rate of 60 percent on each additional dollar earned. . . This total tax rate includes federal, state and local taxes plus the reduction in the EITC."

- Economists at both Texas A&M and the University of Wisconsin have concluded that the EITC has reduced incomes among as much as half of its recipients because they have decided to work less.

- EITC no longer benefits only families with children:

- Families and individuals without children can qualify.

- Between 1993 and 1994 the number of recipients increased 28 percent from 15.2 million to 19.5 million.

- By extending the EITC to childless individuals, thousands of convicts qualified for \$2 million in checks.

- And, it's not just benefiting those deemed eligible — fraud and abuse is rampant:

- The EITC has consistently run a fraud and error rate of 24-40 percent, thus making it the most fraudulent welfare program Washington runs. The IRS and GAO estimate fraud and error to have been 39 percent in 1982, 34 percent in 1985, and 34 percent in 1988. By comparison, Food Stamps and AFDC are considered to have excessive fraud rates if they exceed 6-8 percent.

- Since its inception, EITC has lost \$25 billion to fraud and abuse and, if the historical pattern continues, the GAO estimates an additional \$37 billion in losses over the next five years.

- Often income is overstated in order to receive the maximum credit. This problem is particularly difficult for the IRS since it is geared to detecting the understatement of income. Additionally, auditing these returns with their relatively small dollar amounts is relatively expensive.

- Often nonexistent children are reported in order to increase the credit.

- In 1985, 39 percent of EITC payments were made to ineligible recipients.

— In 1988, an estimated \$1.9 billion was incorrectly paid out from total spending of only \$5.9 billion

— The IRS estimates that at least 160,000 illegal aliens claimed the EITC in 1994.

Returning the Low-Income Working Family to the Center

The Senate proposal re-targets the EITC.

- Unintended recipients — illegal aliens, convicts, individuals and families without children — are removed.
- The truly needy will again become the primary focus, by:
 - Including real income that is currently excluded — tax-exempt interest; Social Security benefits not subject to tax; nontaxable pension, annuities, and individual retirement arrangements; and child support received in excess of \$6,000 annually.
 - Excluding real losses from income — net losses from rent and royalties; net capital losses; net losses from sole proprietorships, partnerships, S corporations, real estate mortgage conduits, trusts, and estates; and net operating losses.
- Efforts to combat fraud and abuse are renewed and redoubled by:
 - expediting denial procedures for those not providing Social Security numbers or who fail to pay self-employment taxes; and
 - doubling civil penalties for filing returns which illegitimately claim the credit or other tax items.

Only in Washington. . .

"Most unbelievably of all, 17 million working families who seek to share in the American dream will have to pay \$42 billion more in income taxes through reductions in the earned income tax credit for working families. . . Now, what the Congress wants to do is to roll back that working family's tax credit, in a way that will impose a tax increase averaging \$500 a family on families least able to pay it. This is a tax hike that literally will push many working families back into poverty."

(President Clinton, weekly radio address, October 7, 1995)

Only in Washington is an increase in spending called a spending cut, and only in the White House could it be called a tax increase!

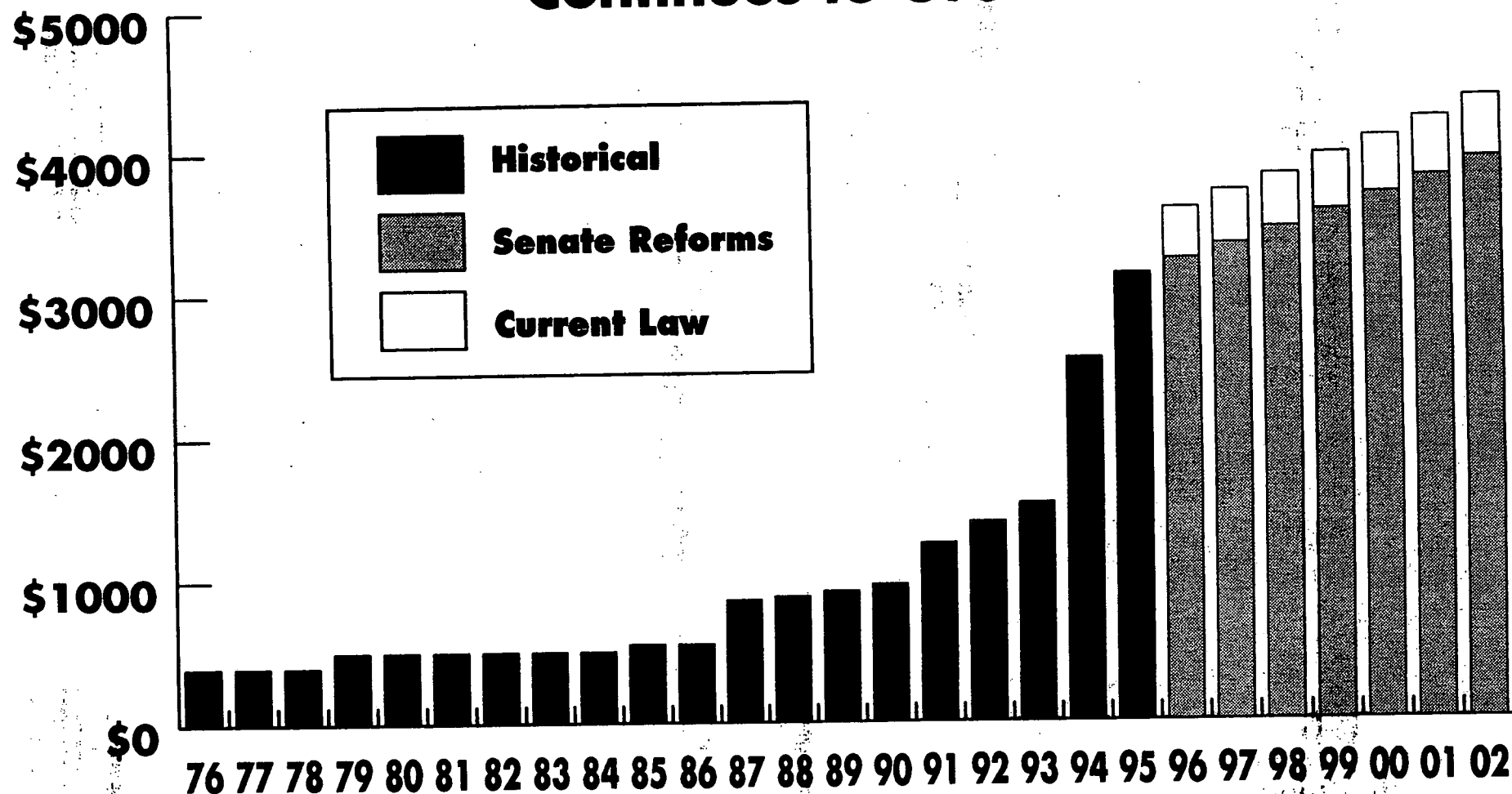
EITC — and Clinton's Criticism — Miss the Mark

In the last 20 years, the EITC has moved consistently away from its intended target: working low-income families with children. As a result it has simultaneously experienced dramatic increases in fraud and spending. The Clinton Administration has responded to these trends by further dispersing the EITC. In contrast, the Senate Finance Committee proposal is a bull's-eye. It refocuses the program so that truly low-income working families with children are both assisted and given work incentives, and those ineligible no longer benefit through fraud and abuse. The result is a program that will better serve both low-income working families and American taxpayers.

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SENATE EITC REFORM

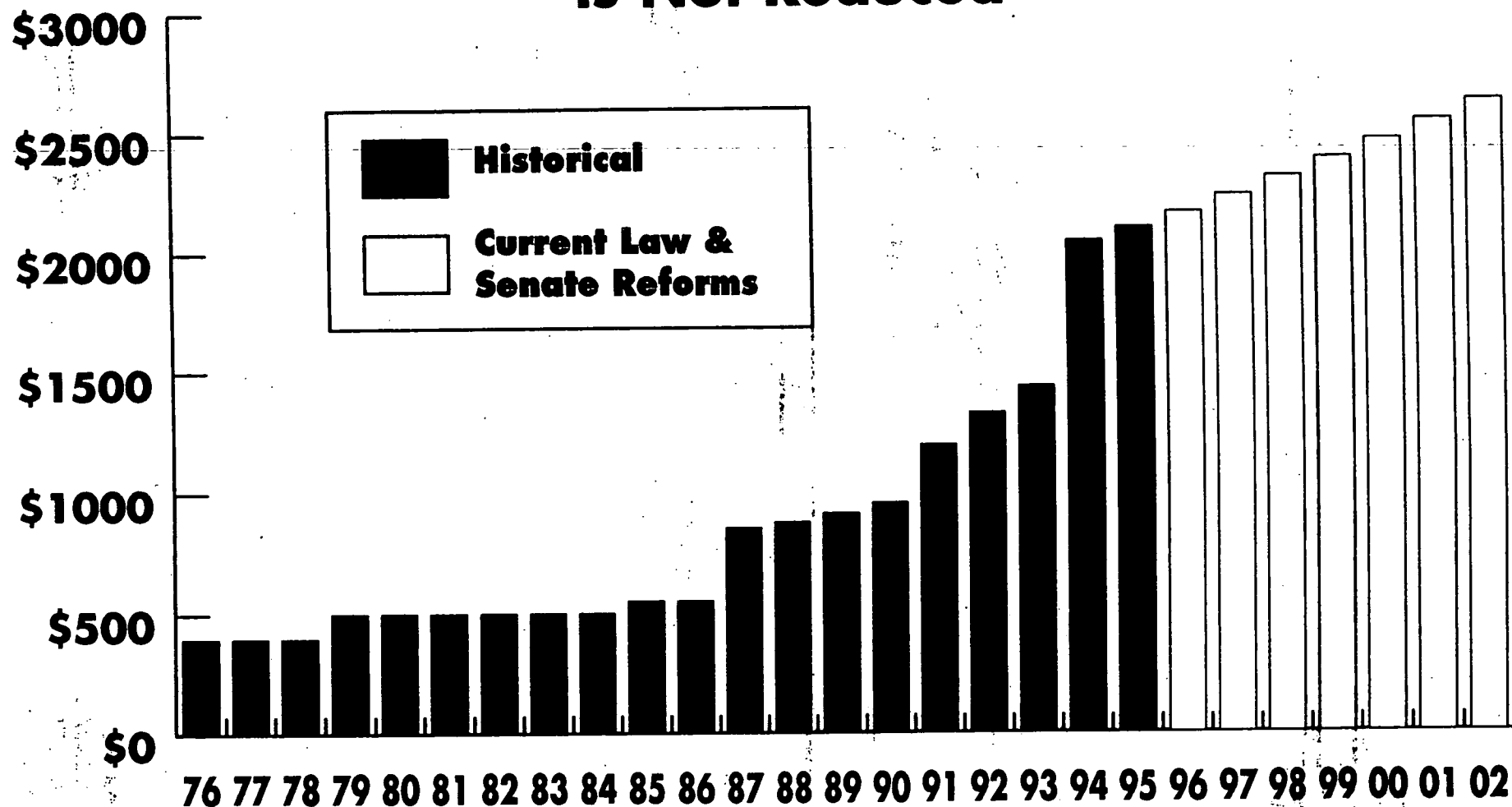
The Maximum Credit for Multiple Children Continues to Grow



SOURCE: Joint Committee on Taxation

SENATE EITC REFORM

The Maximum Credit for One Child Is Not Reduced

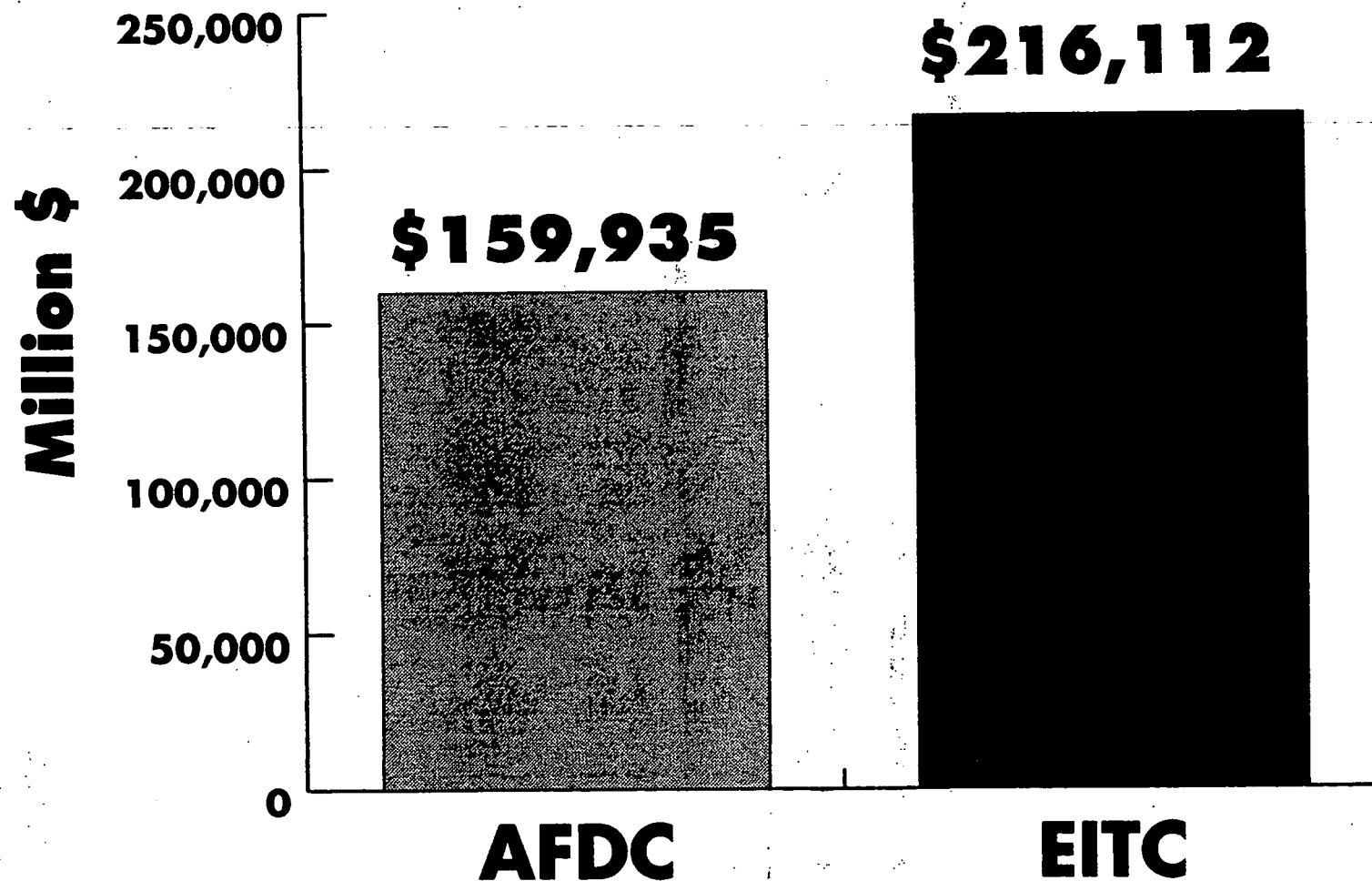


SOURCE: Joint Committee on Taxation

GROWTH IN THE EITC DWARFS MEDICARE & MEDICAID GROWTH

	1985 Federal Spending (billions \$)	1995 Federal Spending (billions \$)	Total Percent Increase
Medicaid	22.7	89.2	293%
Medicare	69.5	178	156%
EITC	2.1	24.0	1,100%

Projected Federal Spending on AFDC v. EITC Program Under Current Law 1995-2002



Source: Congressional Budget Office